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C O N F I D E N T I A L SECTION 01 OF 03 CARACAS 000452

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SUBJECT: VENEZUELAN AUTO INDUSTRY NEARING COLLAPSE

CARACAS 00000452 001.2 OF 003

Classified By: Economic Counselor Darnall Steuart for reasons 1.4 (b) and (d).

SUMMARY
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¶1. (C) Lack of access to controlled dollars is bringing the Venezuelan automotive sector to the point where it will begin to shut down at the end of April if the Foreign Exchange Control Commission (CADIVI) does not quickly make available large amounts of foreign exchange. The seven assemblers and their local suppliers are reportedly owed USD 2.2 billion; their foreign suppliers have cut off shipments until arrears are cleared. The local industry relies heavily on imported raw materials, intermediate goods, and components. In addition, assemblers have not received CADIVI approval to repatriate dividends since the 2006 fiscal year. In the past nine months, labor conflicts have closed several of the assemblers for extended periods, resulting in lost production and further exacerbating the financial problems of their local suppliers. Finally, the new auto regime legislated in 2007 became effective on April 1 despite the failure of the government to fulfill its own commitments to the program, making it impossible to comply.

¶2. (C) Commercial Officer Koloditch visited the U.S. "Big Three" auto assemblers on March 30-31. All told similar stories and restated dire pronouncements issued at an industry-wide press conference the week of March 23. All the local assemblers (GM, Ford, Chrysler, Toyota, MMC (Mitsubishi, Hyundai, and Fuso Trucks), Fiat's Iveco, and Mack Trucks) participated in the press conference in conjunction with the two major auto sector industry associations, the Venezuelan Automotive Assemblers Chamber and the Auto Part Manufacturing Chamber. According to the Big Three, the press conference was intended to elicit action from the Bolivarian Government of Venezuela (BRV) by detailing the industry's woes and signaling the progressive shut-down of the sector beginning at the end of April if more substantial foreign exchange was not quickly made available. No government reaction has been forthcoming.

FOREIGN EXCHANGE ISSUES
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¶3. (C) The government, through CADIVI, owes foreign and domestic suppliers to Chrysler USD 180 million, to Ford USD 250-300 million, and to GM a whopping USD 800 million for imports. (Under CADIVI, the foreign suppliers receive payment directly, with the importers supplying bolivars.) Chrysler's President Luis Perez de la Cruz (protect) reported that some CADIVI payments for imports were as much as 200 days late. Ford's President Gabriel Lopez (protect) said

that sporadic payments were delivering USD 1-2 million per week while their needs averaged USD 10 million per week. GM's President Ronaldo Znidarsis (protect) said his monthly foreign exchange requirements totaled USD 120 million, but that GM had received nothing in December, January, or March, and just USD 40 million in February. Receipts for some previous months had been only partial, as well. All said that payments were unpredictable and seemed to obey no formula or schedule. They complained that a steady and predictable payment flow was required to keep their suppliers shipping product. The result is that their suppliers have largely cut off shipments, leaving them without materials to assemble. Chrysler and Ford will begin to reduce production at the end of April, with closure not far behind. GM, which began to stockpile inputs last year when payments became problematic in anticipation of further problems, can hang on a little longer, but will cut one of three shifts on May 1, the second in August, and the third not long thereafter. GM's brand-new truck assembly plant, inaugurated late in 2008, will cut one of two shifts in May and the other during the summer. The company's foreign suppliers stopped shipments in the second week of January. The assemblers can and do resort to the (legal) parallel exchange market, but at a high cost, currently 6.3 bolivars per USD versus 2.15 in the official market. All three are resorting in various degrees to the parallel market for their direct imports and to replace critical parts unavailable from their regular local suppliers. Ford uses the parallel market for 30 percent of its imports.

¶4. (C) Even if the assemblers could manage to keep their foreign suppliers on board, the situation at local suppliers could bring production to a halt. Suppliers, many of them small, are in even worse shape than the assemblers. Few have the financial wherewithal or working capital financing to pay their own suppliers through the parallel market. Several



have already gone out of business due to foreign exchange shortages or labor conflicts and many will quickly follow, making it impossible for assemblers to meet local content requirements. All of the Big Three are subsidizing suppliers by providing them with foreign exchange purchased in the parallel market in order to keep the supply of parts coming and raising prices to compensate.

¶5. (C) Dividends are another headache for the assemblers. Ford reported arrears of USD 157 million for calendar years 2006 and 2007. GM said it is owed USD 300 million. Chrysler had no profits to repatriate during the years for which payments are delayed. All three are in the process of preparing filings to obtain 2008 dividends.

NEW AUTO REGIME
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¶6. (C) The auto regime legislated in 2007 is also having negative effects. The regime requires major industry changes, among them a new system of import quotas for finished vehicles, increased local content requirements (including local engine assembly by 2010 and 50 percent local content by 2013), and a requirement that all vehicles sold in Venezuela by January 1, 2008, be dual fuel (either gasoline-compressed natural gas or diesel-compressed natural gas). This was later postponed until April 1, 2009, with only a 30 percent requirement. Quotas for 2008 were greatly reduced from prior year imports, but actual imports were even less because of lack of clarity in the law and discretionary behavior by customs and other government officials. The BRV has issued no quotas so far for 2009. It would take three to five months for cars to become available in the Venezuelan market following quota issuance, depending on their provenance. The Big Three do not expect any quotas for 2009 to be issued. This impacts the local assemblers less than mere importers since their dealers derive most of their revenue from parts and service. The situation of dealers for

other auto companies (too numerous to name) that merely import vehicles varies by their length of time in the market. Recent arrivals (i.e., those without large existing fleets) will begin to close dealerships this summer.

¶7. (C) The dual fuel requirement has caused consternation among the assemblers. All have invested substantial amounts in altering their assembly lines and designs to accommodate the conversion kits, USD 15 million in the case of Chrysler, the smallest of the Big Three in Venezuela. The latest deadline of April 1, 2009 (two extensions were earlier granted) cannot be met because the government has not fulfilled its part of the program. It has not started to install the necessary compressed gas delivery points at any assembly plant (this will require about three months) and has not imported kits the regulation requires it to provide for free to the assemblers. Originally PDVSA (state oil company) was to import the conversion kits and install them at a purpose-built facility. After the assemblers pointed out that the kits needed to be built into vehicles and not retro-fitted, PDVSA was to buy the kits and deliver them to the assemblers. The BRV then proposed that assemblers buy the kits and wait for reimbursement from PDVSA. Given the existing CADIVI payment backlog, the assemblers naturally declined. The assemblers now are negotiating an intermediate course under which PDVSA or the assemblers will provide a down-payment for the kits with the balance to be paid later. It is unclear what will happen now that companies cannot immediately comply with the 30 percent dual fuel requirement; the deadline has not been formally extended.

## LABOR ISSUES

¶8. (C) The Big Three reported varying degrees of labor difficulties. GM, which was shut down for almost two months in the summer of 2008 by seizure of its plant by a militant parallel union that eventually won the right to represent its workers, reported that it faces almost daily demands for increases in one or another benefit. Ford has already begun negotiating its new agreement a full 18 months before the contract is up and must negotiate with two unions. Chrysler's contract is up in June; it has begun negotiating. All face high absenteeism engendered by a non-separation clause in Venezuelan law that is liberally interpreted by the courts. This limits capacity utilization and raises costs.

¶9. (C) These problems are not unique to the American assemblers. Other assemblers also face parts shortages caused by a lack of timely foreign exchange payments, as well as labor problems. MMC was closed for over three months by a



strike and plant seizure. Toyota just went back to work after a four-week stoppage.

## COMMENT

¶10. (C) The BRV faces a severe foreign exchange shortage at the moment due to low oil prices, and is prioritizing foreign exchange distribution, with food, medical supplies and capital equipment being favored for foreign exchange payments. Auto sector imports do not seem to be a priority for the government, not surprising given that its core support comes from poorer Venezuelans who cannot afford cars. The GBRV is, however, playing with fire. The auto sector employs about 12,000 workers at the assemblers and many thousands more at the parts manufacturers and dealers. Chrysler estimates total sector employment at some 80,000, a large number in Venezuela. These are typically better-paying jobs than those available to most Venezuelans. At least 30 percent of the two main industrial parks in Valencia, Venezuela's most important non-oil industrial center, are directly related to autos. The problems in the auto sector, moreover, are symptomatic of a problem looming throughout the

Venezuela economy, which imports a large portion of all industrial inputs and components. Low oil prices could force Venezuela to choose between importing food and medicine, importing industrial goods without which employment will plummet, and high inflation as more transactions are forced to move to the parallel market.
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